

## IND AS 2 Inventories

### 1.SCOPE OF IND AS 2

This Standard is applicable to all Inventories, except:

- Any financial instruments held as stock in trade which includes shares, debentures, bonds etc. (INDAS 32, 109)
- Biological Assets (i.e. living plants and animals) related to agriculture activity and agriculture produce at the point of harvest (IND AS 41)

### 2.MEANING OF INVENTORY

Inventories are Assets:

- (a) Held for sale in the ordinary course of business (Finished Goods)
- (b) In the process of Production for Such Sale (WIP) or
- (c) In the form of materials or supplies to be consumed in the production process or in the rendering of services (Raw Material).

### 3.Measurement of Inventory

Measured at lower of Cost or Net Realisable Value.

#### \* What is Net Realisable Value?

The actual transaction price (i.e. customer order price) after the balance sheet date could be the best available evidence to identify NRV of Finished Goods or Stock in Trade.

#### **NRV In Respect of Finished goods:**

Normal selling price of the Finished Goods	XXXX
Less - Estimated Expenditure to sale such goods	XXXX
Net Realisable Value	XXXX

#### **NRV In Respect of WIP:**

Normal selling price of the Finished Goods	XXXX
Less - Estimated Expenditure to sale such goods	XXXX
Less – Estimated further Cost to Make Finished Goods	XXXX
Net Realisable Value of WIP	XXXX

## Measurement of Raw Material:

### If finished goods sold at Cost or Above:

Estimated Realisable value of Raw material and supplies is considered more than cost. Therefore, Raw Material should be measured at Cost.

### If finished goods sold at below Cost:

Estimated Realisable value of Raw material or supplies may be less than Cost. Therefore, Raw Material should be measured at Replacement Cost or Original Cost whichever is lower.

Notes:

- Estimates of Net Realisable Value also take into consideration the purpose for which the inventory is held. For example, the net realizable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price.
- If the sales contract are for less than inventory quantities held, the net realizable value of the excess quantity is based on general selling prices.
- If there is a firm contract to sell quantities in excess of inventory quantities that the entity holds or is able to obtain under a firm purchase contract, this may give rise to a onerous contract liability that should be provided for in accordance with INDAS 37 "Provisions, Contingent liabilities, Contingent Assets".

### Example:

**Computers and laptops on 31/03/20X1 :- 150 units**

**Normal Selling Price :- Rs.1,20,000/- per unit**

**On 30/04/20X1, customer order for supply of 100 units @ Rs.95000/- per unit**

**Calculate the NRV of total 150 units.**

Solution:-

Sno.	Particulars	Amounts
1	100units X 95,000	9,50,000
2	50units X 1,20,000	60,00,000
Total NRV		1,55,00,000

### \*What is Cost of Inventory?

There can be three types of cost are included in the inventory which are as follow.

#### A). PURCHASE COST:

- Invoice price at which goods are purchased

- Duties and taxes paid
  - Transport, Handling and Freight inward
- Any other expenditure directly relating to acquiring goods or services  
Above cost should be reduced by following:
- Duties and taxes received or receivable back from the tax authority
  - Trade discount
  - Rebate
  - Duty drawback

Note :-

- Primary packing charges of material is included in cost.
- Secondary packing and publicity charges of material is recorded as Selling expense in  
Statement of P&L

### **B). COST OF CONVERSION (Labour + Production Overhead)**

- Direct Material, Labour and other direct expense.
  - Plus a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.
- Following things should be considered for conversion cost of the inventory.

#### **(a) FIXED PRODUCTION OVERHEAD**

For example – depreciation and maintenance of factory building.  
Allocation of fixed expense should be made on the bases of normal capacity

If production levels are abnormally low → Unallocated overheads are recognized as an expense (P&L)

If production levels are abnormally high → Amount of Fixed O/H allocated to each unit is Decreased so that inventory should not be measured above cost.

#### **(b) VARIABLE OVERHEAD**

Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

### **C. OTHER COST:**

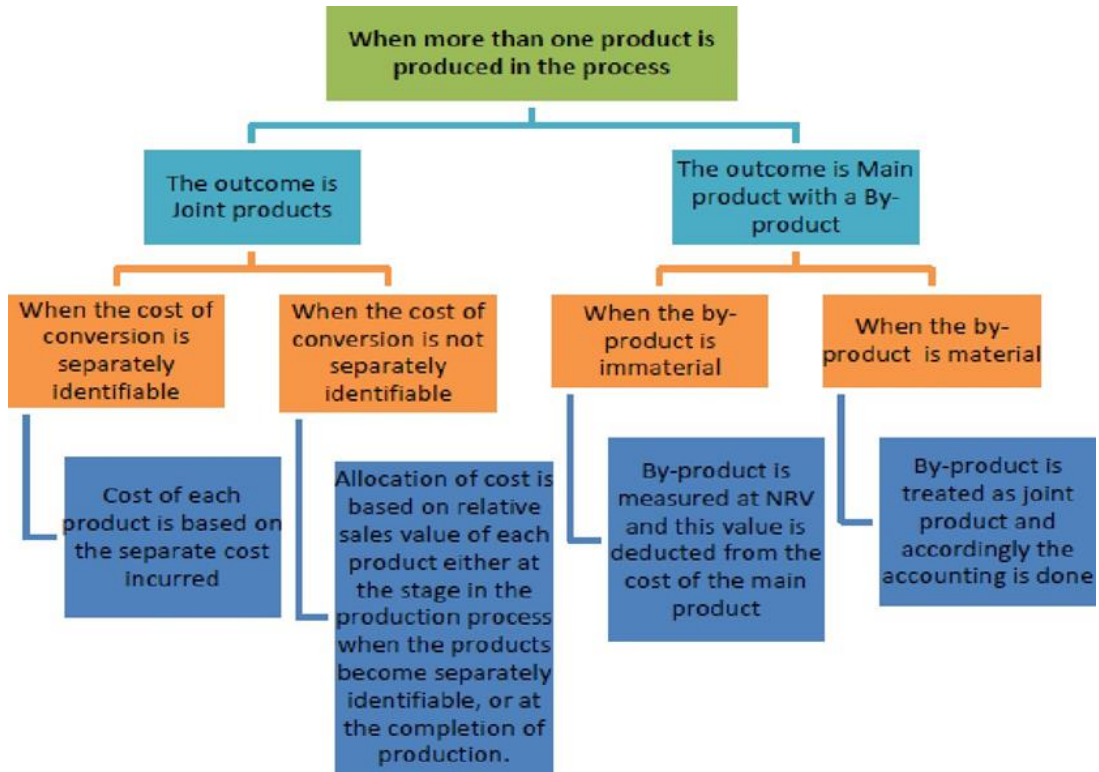
It includes any other expenditure incurred to bring inventory in the present location and condition.

For eg. Transportation cost from factory to warehouse for storage of goods.

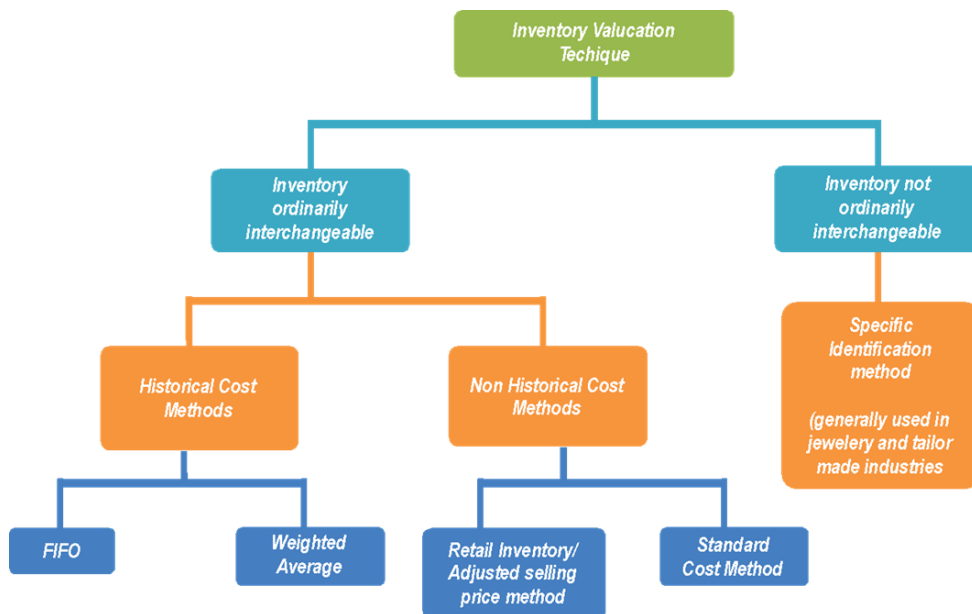
But rent for such warehouse is not other cost & not a part of cost measurement.

Exclusion in Cost of Inventory - But it should not include abnormal wastage relating to material and labour, storage cost, administrative expenses & selling and distribution expenses, finance element in case of deferred settlement.

#### 4.ALLOCATION OF COST TO JOINT PRODUCTS AND BY PRODUCTS



#### 5.TECHNIQUES FOR THE MEASUREMENT OF COST



**Historical Cost Method:**

- (I) FIFO Method: (First in First Out) This method assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those met recently purchased or produced.
- (II) Weighted Average Method: Under this method, the cost of each items is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period.

**Non Historical Cost Method:**

- (i) Standard Cost Method: Cost is based on normal levels of materials and supplies, labour efficiency and capacity utilization. They are regularly reviewed and revised where necessary.
- (ii) Retail Method: Cost is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory that has been marked down to below its original selling price. This method is often used in the retail industry for measuring inventories of rapidly changing items that have similar margins.

Note: Ind AS 2 Inventories does not permit using LIFO (last-in-first-out).

# **IND AS 8 – ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES & ERRORS**

## **1. SCOPE**

This standard shall be applied in

- selecting and applying accounting policies;
- accounting for changes in accounting policies;
- accounting for changes in accounting estimates; and
- accounting for corrections of prior period errors.

However, tax effects of retrospective application of accounting policy changes and correction of prior period errors are not dealt with in this standard. The tax effects of these items are dealt with Ind AS 12, 'Income Taxes'.

**Note:** Requirements of Ind AS 8 in respect of changes in accounting policies do not apply in an entity's first Ind AS financial statements.

## **2. ACCOUNTING POLICIES**

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

Examples: Measurement basis of PPE as per Cost Model or Revaluation Model, Measurement of Cost of Inventory FIFO, Weighted average, etc.

### **Selection and Application of Accounting Policies:**

When an Ind AS specifically applies to a transaction or event, the accounting policy or policies applied to that item shall be determined by applying that particular Ind AS.

In the absence of an Ind AS that specifically applies to a transaction or event, management shall use its judgement in developing and applying an accounting policy along with following sources in the descending order:

- (a) Any other Ind AS dealing with similar and related issues;
- (b) The Framework of Ind AS
- (c) Most Recent pronouncement of International Accounting Standards Board (IASB) or any other standard setting bodies
- (d) Accepted Industry practices.

### **Consistency of Accounting Policies:**

An entity shall select and apply its accounting policies consistently for similar transactions and events, unless an Ind AS specifically requires or permits categorisation of items for which different policies may be appropriate.

### **Changes in Accounting Policies:**

- An entity shall change an accounting policy only if the change:
  - (a) Is required by an Ind AS; or
  - (b) Results in providing reliable and more relevant information on the entity's financial position, financial performance or cash flows.

### **The following are not change in Accounting Policies:**

- (a) The application of an accounting policy for transactions and events that differ in substance from those previously occurring;  
Example: Cost Model for Investment Property and Revaluation Model for PPE
- (b) The application of a new accounting policy for transactions and events that did not occur previously or were immaterial. Example: Measurement of different Inventory product at FIFO.

### **How to apply the Changes in Accounting Policies?**

While discussing the process for application of changes of accounting policies, Ind AS 8, bifurcates it into two situations.

1. If the change in accounting policy is due to new Ind AS, then generally the standard itself will provide the guidance for implementation. In such cases the company needs to follow the guidelines and implement the provisions accordingly.
2. If the change in accounting policy is made voluntarily or where the Ind AS is not clearly setting up any guidelines clearly for transitional period, then the accounting policy needs to be applied retrospectively.

### **Retrospective Application**

- a) Adjust the comparative amounts of previous year.
- b) Adjust the Opening Balances of Assets and Liabilities of Previous year for effects of changes in accounting policy and difference is transferred to retained earnings.
- c) If it is impracticable to follow retrospective application (means entity is not able to apply new accounting policy retrospectively with reasonable efforts), then entity should apply accounting policy prospectively.
- d) Disclosures: following disclosures are required in notes to accounts
  - (i) Nature of change in accounting policy
  - (ii) Effects of such change in current year and previous year (Amount)
  - (iii) If it is impracticable to apply retrospectively, then disclose the reasons.

#### **Example 1:**

An entity changes in 20X6 its accounting policy with respect to determination of cost of its inventories from FIFO to weighted average cost formula. This change is made because management believes that weighted average cost formula results in better matching of

cost with revenue. Further, weighted average cost formula is generally used by other entities whose business is similar to that of the entity and, hence, provides reliable and more relevant information to the users of the financial statements. This being a voluntary change, it has to be applied retrospectively. The entity had commenced operations in 20X1. No records of earlier years are available as a virus attack on server in 20X6 had wiped off all past records. It is not possible to recreate the records. It is therefore impracticable to determine the cumulative effect of change in policy at the beginning of 20X6. The entity will apply the change in accounting policy prospectively from 20X6 only. Since the change in policy is applied prospectively from 20X6, the question of adjusting comparative information for any prior period(s) presented does not arise at all. Cost of closing inventories for 20X6 alone will be determined using weighted average cost formula. The carrying amount of closing inventories for 20X5 will simply be carried as carrying amount of opening inventories for 20X6. Cost of closing inventories for 20X5 determined on FIFO basis will be the starting point for applying weighted average cost formula during 20X6.

### **3. CHANGES IN ACCOUNTING ESTIMATES**

#### **Meaning**

- As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with accuracy but can only be estimated.
- Estimation involves judgments based on the latest available, reliable information. For example, estimates may be required for:
  - ❖ Bad debts;
  - ❖ Inventory obsolescence;
  - ❖ The fair value of financial assets or financial liabilities;
  - ❖ The useful lives of, or expected pattern of consumption of the future economic benefits depreciable assets; and
  - ❖ Warranty obligations.

#### **Accounting Treatment for a Change in the Estimates**

The effect of change in an accounting estimate, shall be recognized prospectively by including it in profit or loss in:

- (a) The period of the change, if the change affects that period only; or
- (b) The period of the change and future periods, if the change affects both.

#### **Disclosure of changes in estimates**

- An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods.
- If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

## **Change in Accounting Policy vs. Change in Accounting Estimates**

When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

### **Example 2:**

A change in the estimate of the amount of bad debt affects only the current period's profit or loss and therefore is recognized in the current period.

However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognized as income or expense in the current period. The effect, if any, on future periods is recognized as income or expense in those future periods.

### **Example 3:**

A new retail entity provides for warranty obligation 2% of its sales. After being in trade for 3 years because of its stringent quality control processes, the actual warranty obligations is at 1%. It has now revised and provides for warranty obligations @ 1%. It is a change in accounting estimate.

## **4. ERRORS**

### **Meaning:**

- As per the definition given in Ind AS 8, Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information.
- Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

### **Example 4:**

The following arithmetical error occurred in preparation of A Limited financial statement of immediately preceding financial year – (a) Depreciation on plant and machinery understated by an amount equal to 0.30% of sales; (b) Warranty provisions understated by an amount equal to 0.15% of sales; (c) Allowance for bad debts understated by an amount of 0.25% of sales. Individually none of these errors may be material but could collectively influence the economic decision of the users of the financial statements. These are material prior period errors.

### **Treatment of Errors:**

- Rectify the error retrospectively from earliest prior period presented i.e. from the beginning of previous year and transfer the difference to retained earnings.

If it is impractical to rectify the error retrospectively, then entity should restate the items of assets and liabilities prospectively.

**Example 5:**

While preparing the financial statement for the F.Y. 20X2-20X3, the latest prior period presented would be F.Y. 20X1-20X2. If the mistake is discovered for the year 20X1-20X2, then it will be rectified, immediately while presenting the statements for the year 20X2-20X3.

**Example 6:**

While preparing the financial statements for the F.Y. 20X4-20X5, if the mistake has been discovered for the year 20X1-20X2, i.e., for the period which was earlier than the latest prior period presented, then the corrected opening balances as on 1st April 20X3 of equities, assets and liabilities will be restated.

**Disclosure of Prior Period Errors**

An entity shall disclose the following:

- (a) The nature of the prior period error;
- (b) If practicable, the amount of correction for each prior period presented, item by item and also its impact on EPS.
- (c) The amount of the correction made in opening balances of comparative period.
- (d) If retrospective restatement is impracticable, disclose the reasons and from which date it is rectified.

## **IND AS 16-Property Plant and Equipment (PPE)**

### **1.DEFINITION**

#### **A).PROPERTY PLANT AND EQUIPMENT**

Any Tangible item will be called as PPE if it satisfies the following Conditions:

##### **Condition 1.**

Held for Use in

- Production or Supply of goods and services
- For Rental to Others

For Administrative Purposes

##### **Condition 2.**

Expected to be used for more than 12 Months.

### **2. Recognition condition for PPE**

The cost of an item of PPE should be recognized as an asset if, and only if:

- (a) It is probable that future economic benefits associated with the item will flow to the enterprise, and
- (b) The cost of the item can be measured reliably.

Note:

Treatment of Spare Parts, Standby Equipment and Servicing Equipment

**Case I:** If they meet the definition of PPE as per IND AS 16: Recognised as PPE as per IND AS 16

**Case II:** If they do not meet the definition of PPE as per IND AS 16: Such items are classified as Inventory as per IND AS 2.

- Treat Expense First as a part of Purchase of Goods
- if at the end of Reporting Period, these items are not yet fully consumed then treat them as Inventory (Closing Stock)

### **3. Measurement of PPE**

<b>A) At Initial Recognition</b>	<b>B) Subsequent measurement on Balance sheet date</b>
COST MODEL	COST MODEL (Or) REVALUATION MODEL

**Note:** Selection of Any Model at BS date is an Accounting Policy

## **A) INITIAL RECOGNITION**

Cost of an item of PPE comprises:

### **COST Includes:**

(a) Purchase Price including Import duties and Non- refundable Taxes

(b) Any Directly attributable Costs bringing the Asset to its 'location and condition'

Example:

- Cost of Employee benefits on construction or acquisition of PPE
- Installation Cost
- Cost of Testing the PPE
- Professional Fees
- Initial delivery Cost etc

(c) Decommissioning Restoration and Similar Liabilities -This cost is to be estimated using appropriate discounting rate i.e. it should be recognized initially at PV of future outflow.

### **COST Excludes:**

- Cost of Opening new business such as inauguration cost
- Startup Costs (i.e. Legal Expenses)
- Cost of introducing a new product including advertising
- Initial operating losses
- Cost of relocating or reorganizing part or all the operations of an enterprises.
- Administrative and other general overheads
- Abnormal Cost/Losses (eg. Loss due to strike)
- Staff Training Costs

Note: Excess of Net Proceeds from Sale of Items produced during testing will be deducted from the Cost of Item of PPE.

## **4.Measurement of cost at Initial recognition**

### **Case - 1**

If Payment is deferred beyond Normal Credit Terms:

Cost of an item of PPE is the CASH PRICE EQUIVALENT (PV of agreed price) at the recognition date. Total payment - Cash price equivalent = Deemed Interest, charged to P&L over the period of Credit unless such interest is capitalised in accordance with IND AS 23

### **Case - 2**

PPE acquired in Exchange for a Non-monetary Asset or Assets or a combination of Monetary and Non-monetary Assets:

Cost of such an item of PPE is measured at fair value of Asset Given Up (1st Priority) or Asset Received (2nd Priority) unless:

- (i) Exchange transaction lacks commercial substance; Or
- (ii) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

If the PPE acquired is not measured at Fair Value, its cost is measured at the carrying amount of the asset given up. (Refer Practical Examples 1 to 3)

### **Case - 3**

PPE purchased for a Consolidated Price:

Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

Note: In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuer.

### **Case - 4**

Government Grant related to PPE:

If Govt. Grant is received in Kind (i.e. PPE received at Free of Cost or at Concessional Price) then it should be recognised at Fair Value or Nominal Value as per IND AS 20.

### **Case - 5**

Cost of Self Constructed Assets:

Construction Cost excluding Internal profit generated if any but including borrowing Costs.

## **5.Subsequent measurement at Balance sheet date**

An enterprise should choose,

- ◆ Either Cost model, or
- ◆ Revaluation model

As its accounting policy (IND AS 8) and should apply that policy to an entire class of PPE. Any change in Accounting Policy shall have Retrospective effect.

Class of PPE: A class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise.

### Cost Model

After recognition as an asset, an item of PPE should be carried at:

$$= \text{Cost} (-) \text{Any Accumulated Depreciation} (-) \text{Any Accumulated Impairment losses}$$

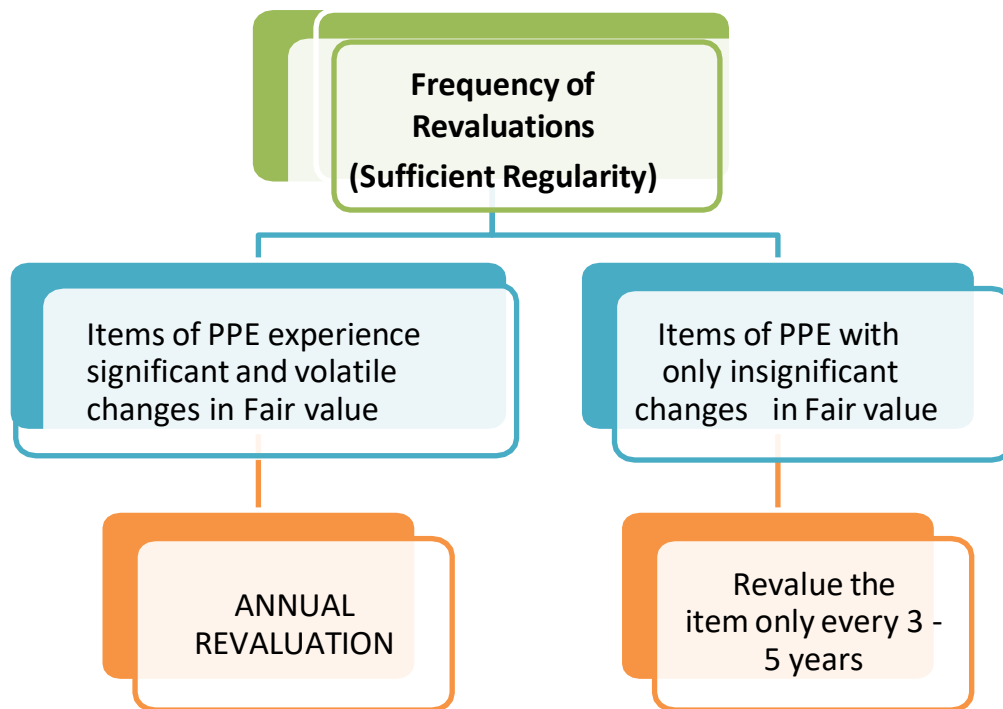
### Revaluation Model

After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount.

Fair value at the date of revaluation -	XXXX
Less: Any subsequent accumulated depreciation	XXXX
Less: Any subsequent accumulated impairment losses	XXXX
Carrying amount	XXXX

### Revaluation for entire class of PPE

If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.



## **6. Accounting Treatment of Revaluation.**

When an item of PPE is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

### **Technique 1:**

Accumulated depreciation is eliminated against the gross carrying amount of the asset

Step 1 – Eliminate the Accumulated Depreciation balance from Gross Carrying amount of PPE (Debit Acc. Dep A/c and Credit PPE A/c)

Step 2 – Now Compare the Net Carrying Amount of PPE with Fair Value of PPE and determine the Revaluation Profit/Loss

Step 3 – Increase or Decrease the Net Carrying Amt. of PPE with the Revaluation Profit/Loss by either Debiting or Crediting the PPE.

### **Technique 2:**

Restatement Approach (No elimination of Accumulated Depreciation)

Gross carrying amount and Accumulated Depreciation is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.

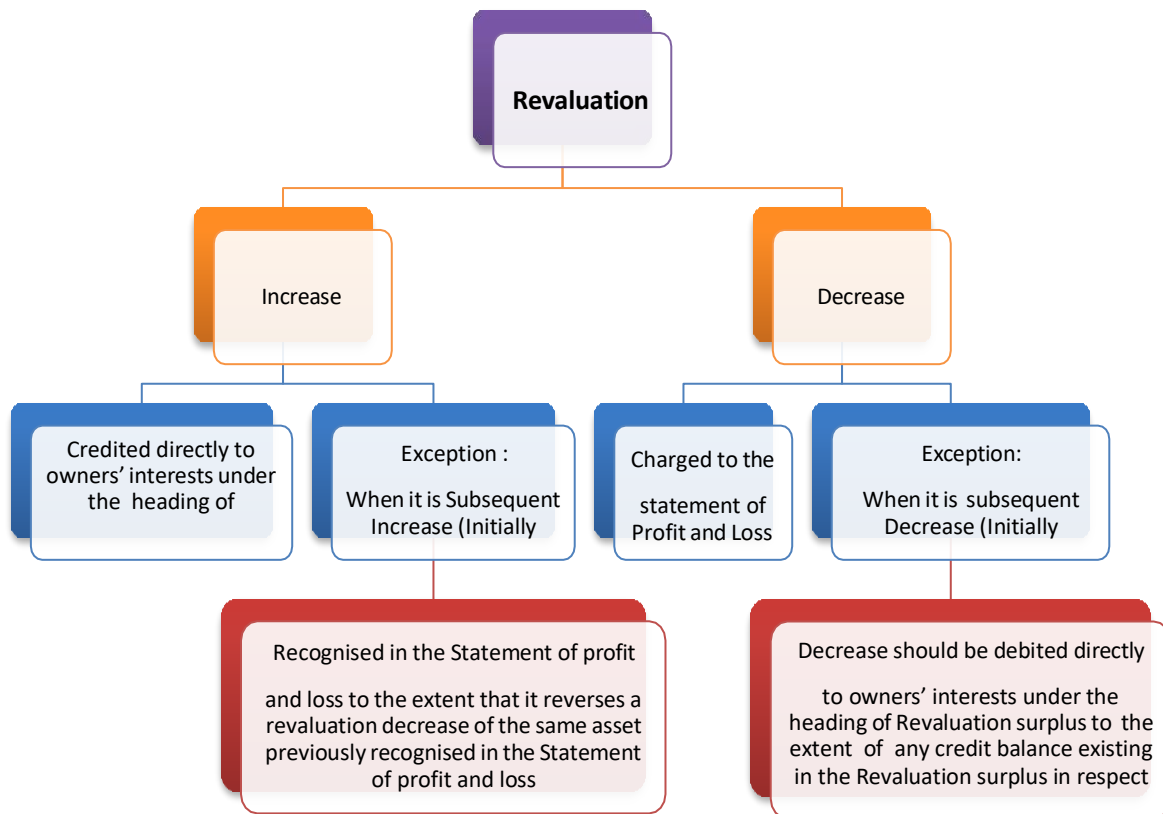
- No need to eliminate Accumulated Depreciation.
- Calculate the Revaluation Gain/Loss and its “% of Change” (Gain (loss) / WDV)
- Increase/Decrease the Original Cost and Accumulated Depreciation with above % and pass following ---- journal entry:

PPE A/c Dr.

To Accumulated Depreciation A/c

To Revaluation Surplus A/c

## **7. (a) Revaluation Increase or Decrease Treatment**



## 7. (b) Utilization of Revaluation Surplus

The revaluation surplus included in owners' interests in respect of an item of PPE may be transferred

to the Revenue Reserves (i.e. Retained Earnings) when the asset is de-recognised.

**Case I:** Mandatory transfer of Revaluation Reserve to Retained Earnings (GR): When the asset is:

- ◆ Retired; or
- ◆ Disposed of

**Case II:** Option to Transfer Revaluation Reserve to Retained Earnings (GR)

- When the asset is still used by an enterprise not yet sold.
- Transfer the amount equal to the excess depreciation due to Upward

Revaluation.

Note: Transfers from Revaluation Surplus to the Revenue Reserves are not made through the Statement of Profit and Loss.

## **8. Depreciation**

### **a) Accounting Treatment:**

Depreciation charge for each period should be recognized in the Statement of Profit and Loss unless it is included in the carrying amount of another asset for example -

- IND AS 2: Depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories as per IND AS 2.
- IND AS 38: Depreciation of PPE used for development activities may be included in the cost of an intangible asset recognised in accordance with IND AS 38 on Intangible Assets.
- IND AS 16: Depreciation of PPE used for construction and development of another self-generated PPE may be included in the cost of self-generated asset in accordance with IND AS 16 on PPE.

### **b) Depreciation amount and Depreciation Period**

What is "Depreciable Amount"?

Depreciable amount is:

Cost of an asset (or other amount substituted for cost i.e. revalued amount) - Residual value

The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

### **c) Review of residual value and useful life of an asset.**

Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with IND AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

### **d) commencement of period for charging depreciation**

Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. (i.e. Ready to use)

### **e) cessation of depreciation**

Depreciation of an asset ceases at the earlier of:

- ◆ The date that the asset is retired from active use and is held for disposal, and
- ◆ The date that the asset is derecognized

Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated.

## **f) Depreciation Method**

The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

The method selected is applied consistently from period to period unless:

- There is a change in the expected pattern of consumption of those future economic benefits; or
- That the method is changed in accordance with the statute to best reflect the way the asset is consumed.

## **g) Review of Depreciation method**

The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern.

## **8. De recognition**

The carrying amount of an item of PPE should be de-recognised:

- On disposal
- By sale
- By entering into a finance lease, or
- By donation, or
- When no future economic benefits are expected from its use or disposal

Accounting Treatment:

- Gain or loss arising from de-recognition of an item of PPE should be included in the Statement of Profit and Loss when the item is derecognized unless IND AS 116 on Leases, requires otherwise on a sale and leaseback (IND AS 116 on Leases, applies to disposal by a sale and leaseback.)

- Compensation from third parties for items of PPE that were Impaired, Lost or Given up shall be included in Profit and Loss when such compensation becomes receivable.

- Gain or loss arising from de-recognition of an item of PPE =

Net disposal proceeds (if any) - Carrying Amount of the item

Component Method of Depreciation:

Each part of an item of PPE with a cost that is significant in relation to the total cost of the item with significant useful life different from other components should be depreciated separately.

## **IND AS 23 BORROWING COSTS**

### **1. SCOPE OF IND AS 23**

- An entity shall apply this standard in accounting for borrowing costs.
- The standard does not apply to actual or imputed cost of equity, including preferred capital not classified as liability.
- The general requirement of this standard (to capitalise directly attributable borrowings cost) is not required to be applied to:

**(a) Qualifying assets that are measured at fair value, for example, a biological asset accounted for under IND AS 41**

**(b) Inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis**

### **2. MEANING OF BORROWING COST**

Borrowing Cost is the:

- (a) Interest and
- (b) Other cost

That is incurred by an enterprise in connection with borrowing of funds.

The following exclusive points should be considered for the purpose of borrowing cost:

- Interest Exp. calculated using the effective interest method as described in IND AS - 109 Financial Instruments.
- Amount of Interest (finance charges) should also be included as a part of borrowing cost which is paid or payable on lease liability recognized in accordance with IND AS 116).
- Exchange Difference arising from Foreign Currency Borrowings to the extent of difference in Interest cost (IND AS – 21).

Important Points:

1. Dividend on redeemable preference share capital is borrowing cost.
2. Equity Dividend or Dividend on irredeemable preference share capital is not borrowing cost.
3. Cost of issue of equity capital is not borrowing cost.

### **3. MEANING OF QUALIFYING ASSETS**

Qualifying Asset means:

- An Asset that takes Substantial period of time to get ready for intended use or sale.

**Note 1:** Normally a period of 12 months is considered to be the substantial period of time. However it is not defined, it can be considered as per the judgment of the entity. If question is silent we can assume that asset is taking substantial period.

**Note 2:** Inventories that are manufactured or produced in large quantities on a repetitive basis and that takes substantial period of time to get ready to sale may not be qualifying asset.

#### **4. Treatment of Borrowing Cost:**

As per IND AS – 23, amount of borrowing cost which is directly attributable to:

- Acquisition; ● Construction; or ● Production of any Qualifying Asset is capitalized.

If any borrowing cost is not having any connection with qualifying assets than such amount should be transfer to Profit and Loss account.

#### **5. TYPES OF BORROWINGS & BORROWING COSTS**

**A. Specific Borrowing:** Loan is taken for specific qualifying asset. Entire borrowing cost shall be capitalized from the date of 1st expenditure on qualifying asset. (I.e. start capitalization of entire borrowing cost from the date of 1st expenditure irrespective of expenses on different dates).

**B. General Borrowing:** Loan is not for any specific qualifying asset. It can be used for any purpose or for multiple assets. Capitalization shall be done expenditure wise (i.e. from the date of each expenditure on qualifying asset). To capitalize the borrowing cost we have to calculate weighted average of the borrowing rate (WABR) as under:

$$\frac{\text{Total Borrowing Cost incurred during the year} * 100}{\text{Total Borrowings O/s during the Year}}$$

#### **Notes:**

If expenditure on qualifying asset is incurred out of specific as well as general borrowed funds then we shall first use specific borrowings if such borrowing is available on the date of expenditure.

In computing the capitalization rate for generally borrowed funds, the entity should exclude borrowing costs on borrowings which are specifically used for the purpose of obtaining a qualifying asset until that specific asset is ready for its intended use or sale.

Once such specific asset is ready for its intended use or sale, borrowing costs related to borrowings of such asset shall be considered as part of general borrowing costs of the entity and be used for computation of capitalization rate on general borrowings.

#### **6. CAPITALIZATION OF BORROWING COSTS**

##### **Commencement of Capitalization:**

Start capitalizing Borrowing cost from the later of following dates:

- a. Date of start of expenditure on acquisition, construction, production of Qualifying Asset
- b. Date of start of incurring interest

c. Date when necessary activities started (Such as technical or administrative work prior to commencement of physical construction)

**Example on Commencement of Capitalization:**

X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

- (i) 15 May 20X1: Loan interest relating to the project starts to be incurred
- (ii) 2 June 20X1: Technical site planning commences
- (iii) 19 June 20X1: Expenditure on the project started to be incurred
- (iv) 18 July 20X1: Construction work commences Identify commencement date.

**SOLUTION: In the above case, the three conditions to be tested for commencement date would be: Borrowing cost has been incurred on: 15 May 20X1 Expenditure has been incurred for the asset on: 19 June 20X1 Activities necessary to prepare asset for its intended use or sale: 2 June 20X1 Commencement date would be the date when the above three conditions would be satisfied in all i.e., 19 June 20X1.**

**Suspension of Capitalization**

Capitalization of Borrowing Costs shall be suspended during the extended periods in which Active Development is interrupted.

Note: Borrowing costs which are related to the suspension period should be transferred to Profit and loss.

However, if necessary activities are interrupted due to unavoidable reason (or) temporary delays is necessary then no need to suspend the capitalization of borrowing cost. (eg. High water level during construction of bridge)

**Example of Suspension of Capitalization:**

Construction suspended between October 20X1 to January 20X2 during which period certain heavy construction equipment under use was shifted to another site. In this case, capitalization of borrowing costs needs to be suspended since active development is interrupted.

**Cessation of Capitalization**

- Capitalization should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- Cessation to take place in part if construction of qualifying asset is completed in parts and a part is capable of being used separately.

### **Example on Cessation of Capitalization:**

H Limited, a real estate company, gives immovable property on rent. It has completed on May 31, 20X1, a commercial complex consisting of various offices that could be rented out. It expects that the commercial complex will be completely rented out by June 30, 20X1. However, due to adverse market conditions, only 10% of the commercial complex could be rented out by its reporting date of March 31, 20X2. H Limited wants to capitalize the eligible borrowing costs incurred up to March 31, 20X2.

H Limited should capitalize borrowing costs only up to May 31, 20X1. The borrowing cost incurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 20X1. The fact that only a small portion could be rented out by March 31, 20X2, is immaterial.

## **7. OTHER RELEVANT CONCEPTS**

### **A. Capitalizing borrowing cost in Group Financial Statements**

- There may be a situation when the borrowings are taken by one company and qualifying asset is developed by another company within a group.
- Borrowing cost in the consolidated financial statements shall be capitalized only when borrowed funds are actually applied on such qualifying asset. (means check the end use of borrowed funds)
- However, the entity carrying out the development should not capitalize any interest in its stand-alone financial statements as it has no borrowings.
- If, however, the entity has intra-group borrowings (loan taken by subsidiary from holding) then interest on such borrowings may be capitalized in its stand-alone financial statements if funds are applied to qualifying asset.

### **B. Notional Borrowing Cost:**

- A notional borrowing cost cannot be capitalized.
- Where an entity has no borrowings and use its own cash resources to finance the construction of property, plant and equipment, the entity cannot assume that interest that could have been earned on that cash represents forgone benefit and could be capitalized.

# IND AS 24 – RELATED PARTY DISCLOSURES

## Why Ind AS 24?

It is quite probable that a related party relationship may have an effect on the profit or loss and financial position of an entity. Therefore, the users of the financial statements of any entity should have the knowledge of:

- Related party relationships of an entity.
- Entity's transactions, outstanding balances, commitments etc. with such related parties.

## 1. DEFINITIONS

The following definitions are relevant for understanding the Standard:

- A related party can be
  - a person or
  - Entity that is related to the reporting entity.
- Close members of the family of a person includes:
  - (a) Children, spouse/domestic partner, brother, sister, father and mother.
  - (b) children of that person's spouse or domestic partner; and
  - (c) Dependents of that person or his spouse or domestic partner.
- Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

### Note:

The definition includes executive as well as non-executive directors who have responsibility for the management and direction of a significant part of the business. It is not necessary that these people should have the 'director' designation. The term also includes members of the management committee(s), if those committee(s) has the authority for planning, directing and controlling the entity's activities.

## 2. Types of Related Party Relationships:

**Type 1:** Reporting Entity and a Person

**Type 2:** Reporting Entity and another Entity

### TYPE 1 – RELATIONSHIP WITH A PERSON

A person or a close member of that person's family is related to a reporting entity if that person:

- (a) Has control or joint control over the reporting entity.
- (b) Has significant influence over the reporting entity; or

- (c) Is a member of the key management personnel (KMP) of
- the reporting entity or
  - a parent of the reporting entity.

**Examples 1:**

1. Mr. A holds 51% of the equity share capital of A Limited. A Limited has no other form of share capital. Since Mr. A control A Limited, he is a related party.
2. Mrs. A is wife of Mr. A. Mr. A hold 51% of equity shares of A Limited. A Limited has no other form of share capital. Mr. A controls A Limited. Since Mr. A is a related party, Mrs. A is also a related party of A Limited.
3. Mr. D is a director of A Limited. Being a member of key management personnel of A Limited, he is related to A Limited.
4. Mr. D is a director of H Limited. S Limited is a subsidiary of H Limited. Mr. D is related to S Limited.

**TYPE 2 –RELATIONSHIP WITH ANOTHER ENTITY**

Following are the related party relationships:

**(a)** Parent Company and all subsidiary companies of that Parent are related to each other.

Note: Fellow subsidiary companies are also related to each other.

**Example 2:** SA Limited and SB Limited are subsidiaries of H Limited. SA Limited, SB Limited and H Limited are related to each other.

**(b)** Associate or Joint Venture(JV) of Parent Company or any of its subsidiary companies are related to the parent and all subsidiary companies.

**Note:**

- i. Subsidiary companies of the above Associate or JV are also related to Parent and all its subsidiaries.
- ii. But Associate/JV of above Associate or JV is not Related Party of the Parent and all its subsidiaries.

**Example 3:** AS Limited is an associate of S Limited. S Limited is a subsidiary of H Limited. SH Limited is another subsidiary of H Limited. AS Limited and SH Limited are related parties.

**Example 4:**

Parent Ltd. has a joint venture in J Ltd. with co-venture X Ltd. and Parent Ltd. has 35% investment (significant influence) in A Ltd.

Here, Parent Ltd. and J Ltd. are related to each other.

Parent Ltd. and A Ltd. are related to each other.

But Parent Ltd. and X Ltd. (Co-Ventures) are not related to each other.

**Example 5:**

X Ltd. has Subsidiaries Y Ltd., Z Ltd., A Ltd. & B Ltd.

Also, B Ltd. has an Associate co. C Ltd. and A Ltd. has an associate co. D Ltd.

Here, Group consist of X, Y, Z, A & B only. Entire group is related party of each other.

C Ltd. is related party of all members of group i.e. X, Y, Z, A & B.

D Ltd. is related party of all members of group i.e. X, Y, Z, A & B.

But C Ltd. and D Ltd. are co-associate and are not related party to each other.

**Example 6:**

R Limited has an associate B Limited. B Limited has a subsidiary S Limited, a joint venture J Limited and an associate A Limited. R Limited is the reporting entity. It identifies B Limited and S Limited as its related parties. J Limited and A Limited are not related parties of R Limited.

**(c)** Two JV companies of the same Venture Entity are related to each other

**Example 7:**

H Limited has entered into 2 joint ventures, JHA Limited (joint venture with A Limited) and JHB Limited (joint venture with B Limited). JHA Limited and JHB Limited are related parties.

But H Ltd. and A Ltd. or H Ltd. and B Ltd. are co-ventures and are not related to each other.

**(d)** Associate of Parent Company and JV of same Parent Company are related to each other.

(Note: if Parent company has two associate companies then they are not related to each other)

**Example 8:**

JH Limited is a joint venture of H Limited. AH limited is an associate of H Limited. JH Limited and AH Limited are related parties.

**(e)** If a Person (including close family member of that person) or an Entity is having Control/JC over one entity and Control/JC or Significant influence or is a KMP of another entity then both entities are related to each other.

**Example 9:** Mr. A controls A Limited (the reporting entity). He also controls B Limited. A Limited and B Limited are related to each other.

**Example 10:** Mr. A controls A Limited (the reporting entity). He is a non-executive director of B Limited. A Limited and B Limited are related parties.

**(f)** If an entity is a Post-Employment benefit plan for the benefit of employees of reporting entity or any related parties of reporting entity.

### 3. NO RELATED PARTY RELATIONSHIPS

- (a) Co-ventures of the same Joint Venture are not related to each other.
- (b) A Person (or his close family member) is a common KMP in both Entities. Both entities are not related to each other.
- (c) A Person (or his close family member) is KMP in one entity and has significant influence in another entity. Both entities are not related to each other.
- (d) Major Customers, Finance Providers, Trade unions, Govt. Departments or agencies, Major Supplier, Franchisor, distributor, Agent etc. only because of their business dealings with entity.

**Example 11:** Mr. A is a director in X Limited. He is also a director in Y Limited. He has no other interest in either of these companies. There are no transactions between these two entities. X Limited and Y Limited are not related parties.

**Example 12:** Mr. A is a director in X Limited. He is also a director in Y Limited. He has no other interest in either of these companies. Y Limited purchases the entire production of X Limited. The transactions are always at arm's length. X Limited and Y Limited may be related parties as it is quite possible that Y Limited may be able to exercise control/significant control over X Limited. As per this Standard substance is more important than mere legal form.

**Example 13:** JV Limited is an equal joint venture of J Limited and V Limited. J Limited and V Limited are not related parties.

**Example 14:** A Bank and B Bank have provided finance to XY Limited. By virtue of the loan agreement, they occupy a non-executive observer seat on the Board of Directors of XY Limited. A Bank and B Bank are not related parties of XY Limited.

### 4. RELATED PARTY DISCLOSURES

The disclosure requirements can be broadly classified into two categories.

- (a) **Category 1:** Relationship between Parent & Subsidiary, following disclosures are required even when there are not transactions between them during the year:
  - 1) Name of Parent or Subsidiary companies.
  - 2) Name of Ultimate Parent Company (if immediate parent is also a subsidiary)
- (b) **Category 2:** Any other Relationship between Entity and a Person or Another entity requires disclosures of relationships and items only when there are related party transactions during the year:
  - 1) Nature of Related Party Relationship
  - 2) Nature and Amount of Transaction during relationship period
  - 3) Outstanding Balance due from or due to as on balance sheet date
  - 4) Expenses recognized in respect of bad-debts due from related parties
  - 5) Provisions created on outstanding balances from related parties

## 5. OTHER IMPORTANT POINTS

- 1) A related party transaction can be transfer of resources, services or obligations between reporting entity and related entities, such as:
  - purchases or sales of goods (finished or unfinished);
  - purchases or sales of property and other assets;
  - rendering or receiving of services;
  - leases;
  - transfers of research and development;
  - transfers under license agreements;
  - transfers under finance arrangements (including loans and equity contributions in cash or in kind);
  - provision of guarantees or collateral;
  
- 2) A reporting entity is also exempt from the disclosure requirements in relation to (i) related party transactions (ii) outstanding balances and (iii) commitments with:
  - (a) a government that has control, joint control or significant influence over the reporting entity; and
  - (b) another entity that is a related party because the same government has control, joint – control or significant influence over both the reporting entity and the other entity.

However, it shall disclose:

    - the name of the government.
    - the nature of the government’s relationship with the entity

# IND AS 27 – SEPARATE FINANCIAL STATEMENTS

## 1. DETAILED OVERVIEW OF THE STANDARD

### The detailed summary of this standard is as follows:

- i. This standard deals with How to Account for Investments in:
  - Subsidiary Co.,
  - Associate Co. and
  - Joint venture Co.in the individual financial statements of Investor (i.e. Parent Co.)
- ii. Separate financial statements are presented in addition to Consolidated Financial Statements (prepared in case of a subsidiary or subsidiaries, Associates and Joint Ventures)
- iii. Entity may present separate financial statements as its only financial statements if it is:
  - a. Exempt from consolidation; or
  - b. Exempt from applying equity method; or
  - c. Entity is an investment entity (it is exempt from consolidation for all of its subsidiaries).
- iv. Investor (i.e., Parent Co.) shall account for its investments in Subsidiary, Associate and Joint Venture either at:
  - Cost or
  - As per Ind AS 109 Financial Instruments i.e., Fair Value [**fair value through profit and loss (FVTPL)** or **Fair Value Through Other Comprehensive Income (FVTOCI)**](i.e., we have choice to value our investments in individual financial statements at Cost or at Fair Value)

**Note:**

  1. However, the above choice is not available for Investment Entities, venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds.
  2. Such entities shall apply FVTPL only on the Investments in Subsidiaries/Associates/JV
  3. Characteristics of Investment Entities are:
    - It has more than one investment;
    - It has more than one investor;
    - It has investors that are not related parties of the entity;
    - It has ownership interests in the form of equity or similar interests.
- v. Apply Cost Model or Fair Value Model to the entire Category of Investments. Category of investments" means broad category such as:
  - Investments in subsidiary,
  - Investments in associates and

- Investments in Joint ventures.

It is possible to apply a "cost" approach in respect of one category and "fair value" approach for another category. However, it is not possible to apply "cost" approach to one subsidiary and "fair value" approach to another subsidiary.

- vi. Income from the Investments in Subsidiaries/Joint Ventures/ Associates shall be recognized in the P&L Statement of the Holding/Investor when right to receive such income is established. Generally, the right to receive the dividend is established when the dividend is approved by the shareholders in their general meeting.
- vii. Investments classified under Cost Model are subject to Impairment testing as per Ind AS 36. No need for impairment testing under Ind AS 36 for FVTPL Model.

## 2. WHAT IF INVESTMENTS ARE HELD FOR SALE?

If Investments in Subsidiary, Associate or Joint Venture are Classified as "Held for Sale" as per Ind AS 105, apply following:

**If Investments are Measured at COST:** Re-measure such Investments as per Ind AS 105 i.e., Carrying Amount or fair value less cost to sell (FVLCTS) whichever is lower.

**If Investments are Measured at Fair Value:** No need to re-measure the investments. Continue to apply Fair Value only.

### Example 1

An entity has invested in a subsidiary and a joint venture. Entity has elected to measure investment in subsidiary at cost and measure investment in joint venture at fair value through profit or loss in accordance with Ind AS 109. Now, at the end of the year, both these investments are held for sale. In such case, the investment in subsidiary will be measured as per Ind AS 105 i.e., at lower of it carrying amount and fair value less costs to sell. However, investment in joint venture is continued to be accounted at fair value through profit or loss as per Ind AS 109.

## 3. WHEN A PARENT CEASES TO BE INVESTMENT ENTITY OR BECOME INVESTMENT ENTITY – Treatment in SFS

- i. **When an Entity becomes an Investment Entity:** Recognize the Investments at FVTPL as per Ind AS 109

### Note:

- a. Any difference between Carrying Amount of Investments and Fair Value of Investments is: Gain/Loss – Transfer to Profit & Loss.

- b. Any cumulative balance in OCI shall be reclassified to Profit &. Loss on the date of disposal of investment.

### **Example 2 (When an Entity becomes an Investment Entity)**

A Ltd. holds investment in a subsidiary X Ltd. and it measures its investment in subsidiary at cost. On 1 April 20X1, A Ltd. becomes an investment entity. On that date, the carrying value of investment in X Ltd. recorded in its books was ₹1,00,000. However, the fair value of that investment on the date of change in status was ₹1,50,000. Hence, A Ltd. should record a gain of ₹50,000 (1,50,000 – 50,000) in the Profit and Loss Account. In this case, assume that A Ltd. was measuring the above investment at fair value through other comprehensive income in accordance with Ind AS 109 prior to change in status. The cumulative gain recorded in other comprehensive income was ₹50,000 and the carrying value of investment was ₹1,50,000. Hence, on the date of change in status, A Ltd. shall reclassify the gain of ₹50,000 from other comprehensive income to profit or loss as if the investment has been disposed by A Ltd. on that date.

ii. **When an Entity ceases to be an Investment Entity:**

**Option I** - Cost model: Fair Value on the date of change of status is taken as deemed cost

**Option II** - Continue as per Ind AS 109

### **Example 3: (When an Entity ceases to be an Investment Entity)**

A Ltd. was an investment entity and was measuring its investment in subsidiary X Ltd. at fair value. On 1 April 20X1, A Ltd. ceased to be an investment entity. On that date, the fair value of investment in X Ltd. recorded in its books was ₹1,00,000. Now, when A Ltd. ceased to be an investment entity, it can measure the investment in X Ltd. either:

- At cost (in such case, the carrying value of ₹1,00,000 will be its deemed cost at the date of change in status), or
- Continue to measure in accordance with Ind AS 109

## **4. REORGANIZATION OF THE GROUP STRUCTURE**

- 1) A parent re-organize the structure of its group by establishing a new entity as its parent
- 2) Ind AS 27 provides guidance on how to calculate the cost of investment when a parent reorganizes the structure of its group by establishing a new entity as its parent.
- 3) Cost of Investment for New Parent Company will be the Carrying Amount of Equity Items of Old Parent Company, subject to below conditions:
  - a) New Parent Company must issue its equity shares as consideration for acquiring shares of old parent company.
  - b) There must be No change in Net worth of whole group.
  - c) Owner's Position in New Group must be same as Position existed in Old Group.
- 4) If above conditions are not fulfilled, then Cost of Investment for New Parent will be Actual Fair Value on the date of Investment.